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Pain at the Pump

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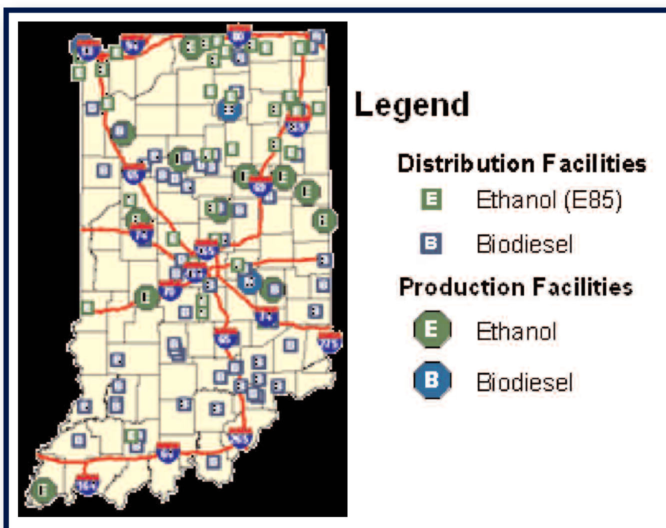
Supply & Demand

Gas prices are at record levels across the country and around the world. The International Energy Agency (IEA) estimates that global oil demand will continue to rise and the share of world oil consumption in developing countries will continue to outpace the rest of the world. Increased mobility in China and India is having a profound effect on the world energy market. While the two countries made up just over one tenth of world oil consumption in 2006, combined they account for one quarter of consumption growth.

Developing countries will continue to outpace the rest of the world in terms of oil consumption

Refining capacity greatly impacts petroleum prices. After capacity reductions in the late 1980s and '90s, world refinery capacity is on the upswing, but refinery capacity in the United States has not kept pace with demand here at home. The ability to refine petroleum products domestically is essential to reducing price in a market with stable or increasing demand. In 1981, the U.S. had 324 refineries producing 18.6 million barrels per day. As of January 2007, there were 149 refineries with an operable capacity of 17.4 million barrels per day. In addition, mature oil fields outside of OPEC are producing less and the IEA approximates more than 3 million barrels per day of new oil will be needed each year to offset falling production in existing oil fields.

There are fewer refineries in the U.S. today than there were 25 years ago.



Increased demand combined with slow growth in refinery capacity has precipitated an increase in world fuel prices. India's price per gallon rose over 19 percent between 2003 and 2005. China's price rose 73 percent between 2001 and 2006. Canada's price increased from $1.38 to $3.26 between 1998 and 2006 and the price of U.S. gasoline increased from $1.06 to $2.57 during the same time period. As of March 17, 2008, the average price of gasoline in the United States was $3.28.

Fuel prices are increasing around the world.

Indiana has not been spared, according to the Indiana Department of Energy. Petroleum has increased in price by 50 percent over the past 2 years and demand for petroleum is at an all time high. Lawmakers at both state and federal levels are focused on reducing America's dependence on foreign energy sources by incentivizing research, development and use of alternative fuels.

Hoosier Opportunity

Ethanol is not new to Indiana. Unbeknownst to many consumers, small percentages of ethanol are routinely added to gasoline, but an ever increasing number of Flex Fuel Vehicles are running on E85—a blend of 85 percent ethanol and 15 percent gasoline. Indiana currently has 97 E85 pumps, so growing numbers of ethanol-compatible vehicles are great news as Indiana continues to lead the search for and development of alternative fuels.

Indiana had one ethanol plant in 2005. Today, 32 biofuel plants are operating, under construction or being planned.

In less than two years, Indiana has moved to preeminence in the production of alternative fuels. Indiana had one ethanol plant and no biodiesel plants in January 2005. Today, six ethanol plants are in operation, nearly a dozen are in planning or construction stages and four biodiesel plants are operating or under construction. On August 21, 2007, Indiana celebrated the grand opening of the Louis Dreyfuss Agriculture Industries LLC biodiesel production plant—the largest soybean-based biodiesel production plant in the world.

Indiana Legislation

Indiana's 2007 Legislative Session further solidified the Senate's commitment to the development and use of alternative fuels. Public Law 33 provides an exemption equal to the 16-cent special fuel tax for biodiesel if the fuel is produced for personal or non-commercial use. Public Law 207 strengthened Indiana Law to provide funding for corn promotion, education and research into new uses for corn and corn co-products as well as sales tax credits for consumers using E85. Public Law 182 provides for a monthly incentive payment to local municipalities using E85 for at least 75 percent of their gasoline needs and establishes a grant program to help fuel stations become E85 compatible. SB 360 in 2008 increased the limit on the amount of the grant from $5,000 to $20,000.

Federal Legislation

Congress has also established several incentive programs in recent years including the American Jobs Creation Act of 2004 (P.L. 108-357), which created tax incentives for biodiesel fuels and extended the ethanol fuel tax credit, and the Energy Policy Act of 2005, which provided federal tax credits for consumers and businesses purchasing fuel-efficient hybrid-electric vehicles, energy-efficient appliances and other products. Federal programs have expanded research into developing hydrogen technologies and has encouraged and allocated money for the research and development of Fischer-Tropsch diesel—a high value, clean burning fuel which is colorless, odorless and low in toxicity and is produced using coal mined in Indiana, Illinois and Kentucky. A national Renewable Fuels Standard has also been implemented to encourage the blending of renewable fuels into our nation's motor vehicle fuel. It required growing renewable fuel use from 4 billion gallons per year beginning in 2006 to 7.5 billion gallons per year by 2012 and it is estimated nationwide volumes will exceed that goal.

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Gasoline Taxes

A common call for legislative action comes in regard to temporary relief from the sales tax on gasoline. While this may seem to be a popular option with taxpayers as prices hover at or above $3 per gallon, closer analysis of Indiana's recent history shows the positive effects on Hoosier consumers were mild and short-lived and unintended consequences of the suspension actually cost taxpayers valuable government services.

When gas prices begin to rise, Hoosiers often ask state government to intervene and artificially bring prices down. However, state government's impact on gasoline prices is limited. The two taxes assessed by the state on fuel most directly impacting Hoosier motorists are the state excise tax on gasoline of 18 cents per gallon and the state sales tax of seven percent.

Most states impose a state excise tax on fuel. Michigan, Illinois and Kentucky's rates are comparable to Indiana's and range from $0.17 to $0.19. Ohio's rate is $0.28 per gallon. Indiana's excise tax is distributed to both state and local units for a variety of road improvement initiatives and is largely responsible for maintenance and upkeep of state highways, county roads and local streets. Because this tax is dedicated to road preservation and upkeep, Hoosiers and lawmakers agree this tax serves a necessary function and even when prices are high Hoosiers are not likely to call for repeal. Indiana has received nearly $2.75 billion since 2002 through the state excise tax.

Indiana is one of only a handful of states imposing a sales tax on fuel purchases, but many impose some other tax in addition to their excise tax. These additional taxes include wholesale taxes, gas taxes, underground storage tank taxes, environmental response taxes, local sales taxes and local gas taxes and most are assessed on a cent-per-gallon basis. Indiana's sales tax rate is comparable to that of both Illinois and Michigan, both of which assess a sales tax on gasoline.

Indiana sales tax revenue, in general, is not dedicated to highway funding. Half the sales tax revenue is dedicated to property tax relief and nearly all the rest is allocated to education, workers' compensation, health care and other government services. Indiana has collected over $1.3 billion in sales tax revenue from the sale of gasoline since 2002. If the sales tax on gasoline were suspended, even temporarily, the state would have to find another way to supply the hundreds of millions of dollars it receives annually from this tax. Every cent of the sales tax is budgeted and the cuts necessitated by repeal would deplete either the state general fund and the amount available for education, health care and workers' compensation or the property tax replacement fund and the amount available to provide property tax relief to Hoosier property owners.

It would also be a mistake to tap into the state's surplus money. Indiana currently has its first surplus in several years thanks to the fiscal restraint of the General Assembly and Gov. Mitch Daniels. This "Rainy Day Fund" stands at $1 billion, but this amount still falls short of the recommended 10-12 percent of revenue necessary to ensure government services can continue even during an economic downturn.

Taxpayers who demand temporary repeal of the sales tax on fuel often cite Gov. Frank O'Bannon's declaration of an "energy emergency" as precedent. By law, an "energy emergency" does not exist simply because prices are high. Under Indiana statute (IC 10-14-3-5), an "energy emergency" is defined as an "existing or projected shortfall of at least eight percent (8%) of motor fuel or of other energy sources that threatens to seriously disrupt or diminish energy supplies to the extent that life, health, or property may be jeopardized." The energy situation in the State of Indiana did not meet this standard in June of 2000 when the O'Bannon Administration made its decision to forego over $40 million in sales tax revenue during a 128-day suspension. Today, experts agree Indiana remains a long way from an 8 percent shortfall in its energy sources.

Many have since questioned if the administration's actions accomplished little more than generating political good will during a gubernatorial election year. While the suspension remained in effect throughout September and October of 2000, the Indiana market actually re-established equilibrium at competitive fuel prices comparable to those of surrounding states. In an article for the American Road and Transportation Builders Association entitled "Who Benefits From Gas Tax Cuts?," Michael F. Martin, Ph.D. writes the State of Indiana lost an average of seven cents ($0.07) in sales taxes per gallon totaling $40 million during the 2000 suspension. Because prices returned to levels consumers were able and willing to pay, Hoosier motorists did not realize the full 7-cent savings intended by suspension supporters. Instead, market forces drove prices. Hoosier motorists, compared to other drivers in the Midwest, saved an average of only four cents ($0.04) per gallon that fall. Perhaps inadvertently, the state allowed a seemingly unintended three-cent ($0.03) windfall for the oil companies. That, in addition to costing state coffers the $40 million that could have gone to worthwhile efforts like K-12 education or property tax relief. In the end, some observers say Hoosiers paid twice for the suspension – once as gas consumers and again as taxpayers.

Conclusion

Prices of traditional gasoline are more greatly impacted by market forces—supply and demand—than ill-conceived temporary government tinkering. Nothing short of increasing supply and/or reducing demand will lower prices over time. Indiana's leadership in alternative fuels and movement toward flex fuel vehicles use both supply and demand to help accomplish this objective. By producing alternative fuels, Indiana increases the supply of fuel choices for consumers. By encouraging the sale and use of flex-fuel vehicles, Hoosiers are helping decrease the demand for foreign oil. Senate Republicans led on both fronts and in-turn provided long-term help to our state's economy and our nation's security.

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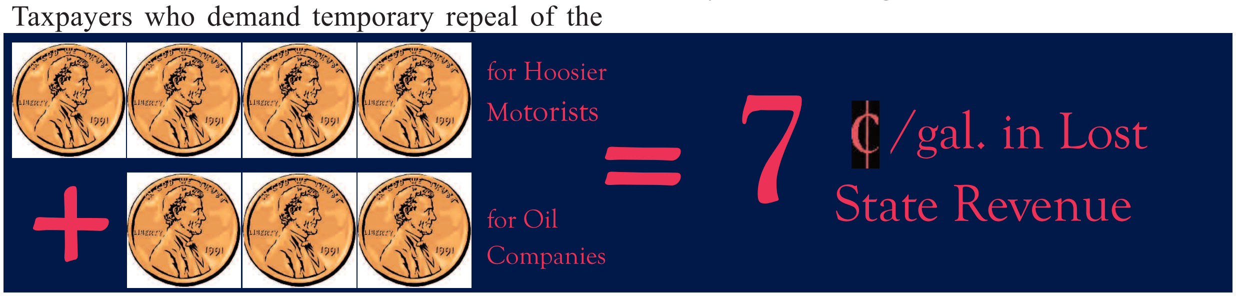

A sales tax suspension on fuel does little to affect the cost of fuel.

Most states impose an excise tax on fuel and Indiana's rate is comparable to surrounding states.

Many states additional taxes in addition to an excise tax.

Indiana sales tax revenue is primarily dedicated to the PTRF and State General Fund.

The sales tax suspension on fuel purchases in 2000 lasted 128 days and cost the state $40 million.

The fuel market in Indiana established equilibrium despite government attempts to lower price.

Producing alternative fuels and encouraging use of flex-fuel vehicles help decrease the price of gasoline in the marketplace.